

Appendix D

REDMOND'S OPERATING ENVIRONMENT 2005-2006

THE ECONOMY

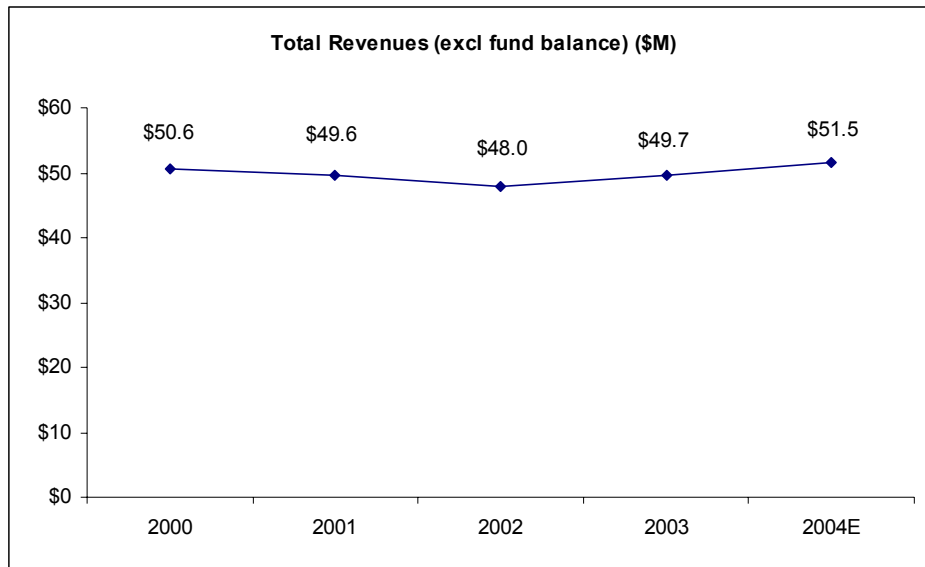
Following one of the longest expansionary periods in the nation's history, the country and the region entered into a short recession starting March 2001 and ending eight months later, a comparatively short time relative to other recessionary periods. While the recession "officially" ended as proclaimed by the National Bureau of Economic Research, employment continued to decline through August 2003. For example, the national unemployment rate rose during this period from 5.7% to 6.3%, causing many economists to characterize this recovery as a "jobless" one.

During this period, Washington State and the region were affected more severely. Boeing, the region's largest employer, began a series of layoffs which shrank its workforce by 30%. Layoffs by Boeing, combined with the collapse of the high-tech industry, resulted in a dramatic rise in the region's unemployment rate, from 3.7% at the end of 2000 to 7.1% at the end of 2003. While the region's unemployment rate has declined to 5.9% as of July 2004, it is still higher than the national average of 5.5%.

IMPACT OF ECONOMY ON GENERAL REVENUES

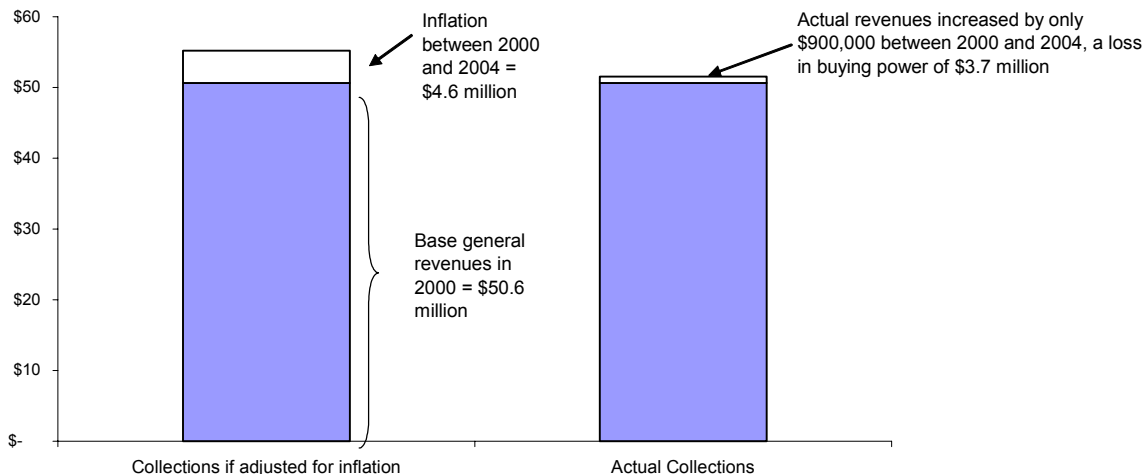
The City of Redmond receives approximately 77% of its general revenues from five sources: sales taxes (31%); property taxes (19%); utility taxes (17%); development fees (7%); and investment interest (2%), all of which are sensitive to changes in the economy. To show how sensitive the City of Redmond's revenues are to economic changes, the following chart shows General Fund revenue performance between 1999 and 2004. Revenues declined in 2001 as the economy weakened and stayed below 2000 levels for three years. While revenues are expected to reach \$51.5 million in 2004, this is only \$900,000 greater than the levels collected in 2000, or an average increase of less than .5% per year. As a measure of comparison, during this same time period costs increased on average by 2.5% per year while general inflation as measured by the Seattle area Consumer Price Index averaged 2.2% per year.

Effects of Recession on General Fund Revenues 2000 vs. 2004



The next graph illustrates the loss in buying power as a result of revenue growth not keeping pace with inflation. The chart below compares 2000 base revenues escalated by inflation through 2004 versus actual collections in 2004. If general revenues grew by inflation during this time period, they would have increased approximately \$4.6 million for a total base of \$55.2 million in 2004. However, actual revenues during this period grew by only \$900,000, or a loss in buying power of about \$3.7 million.

General Revenue Growth vs. Inflation between 2000 and 2004



Development Activity: The level of development activity within the City also serves as a proxy for economic activity. Development as measured by type and size of project is down 66% from the record level posted during the 1999-2000 biennium. The only areas where activity is higher are residential and multi-family housing. These areas are being buoyed by a strong housing

market and low interest rates. It is important to note that although residential and multi-family housing are up that these areas do not generate enough revenue to offset the downturn in commercial and tenant improvement projects. Overall, development fees are down \$2.3 million or 43% from their \$5.4 million peak in 2000.

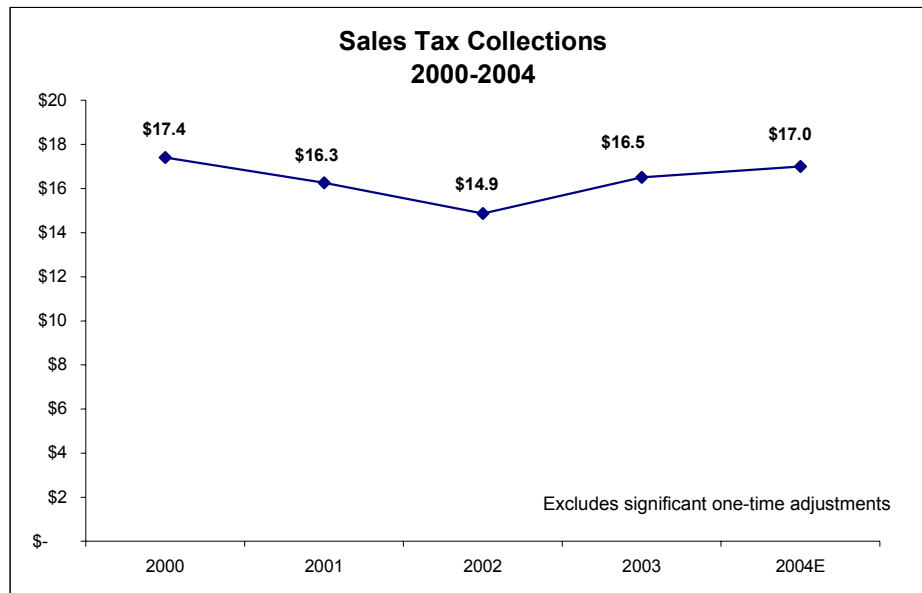
**Development Activity
By Type and Square Footage**

<u>Type of Development</u>	<u>1999-2000 Actual Sq. Ft.</u>	<u>2003-2004 Estimated Sq. Ft.</u>	<u>Percent Increase/Decrease</u>
Commercial	7,514,000	1,220,000	-84%
Multi-family	332,700	647,600	94%
Tenant Improvements	7,599,118	1,799,000	-76%
Residential	<u>893,400</u>	<u>1,865,000</u>	<u>109%</u>
Total	16,339,218	5,531,600	-66%

Source: City Planning Department

The following sections examine the effects of the economy on the City's largest revenue sources: sales tax and property tax.

Sales Tax: Sales tax, which makes up about one-third of Redmond's general revenues, has declined by 2.3% between 2000 and 2004, as shown in the graph below. The City experienced its steepest decline in sales tax revenue between 2000 and 2002, when this revenue fell 14.4%. In addition, it is important to note that sales taxes are still below 2000 levels.



The following table shows how sales taxes performed for Redmond and other selected surrounding jurisdictions between 2000 and 2003. Note: Data for the full calendar year of 2004 was not available at the time of printing and thus not included in this analysis.

Annual Sales Tax Collections - 2000 vs 2003			
Jurisdiction	2000	2003	% Change
Issaquah	\$7.7	\$8.7	13.0%
Renton	\$15.3	\$16.0	4.6%
Kirkland	\$12.7	\$12.7	0.0%
Redmond	\$17.4	\$16.5	-5.2%
Unincorporated King Co.	\$73.5	\$68.6	-6.7%
Seattle	\$123.9	\$113.8	-8.2%
Bothell	\$8.8	\$7.9	-10.2%
Tukwila	\$17.6	\$15.7	-10.8%
Bellevue	\$41.9	\$36.3	-13.4%
Statewide	\$415.8	\$413.9	-0.5%

Source: Wa. State Department of Revenue and City Financial Records.
Statewide figures represent taxable retail sales in billions of dollars.

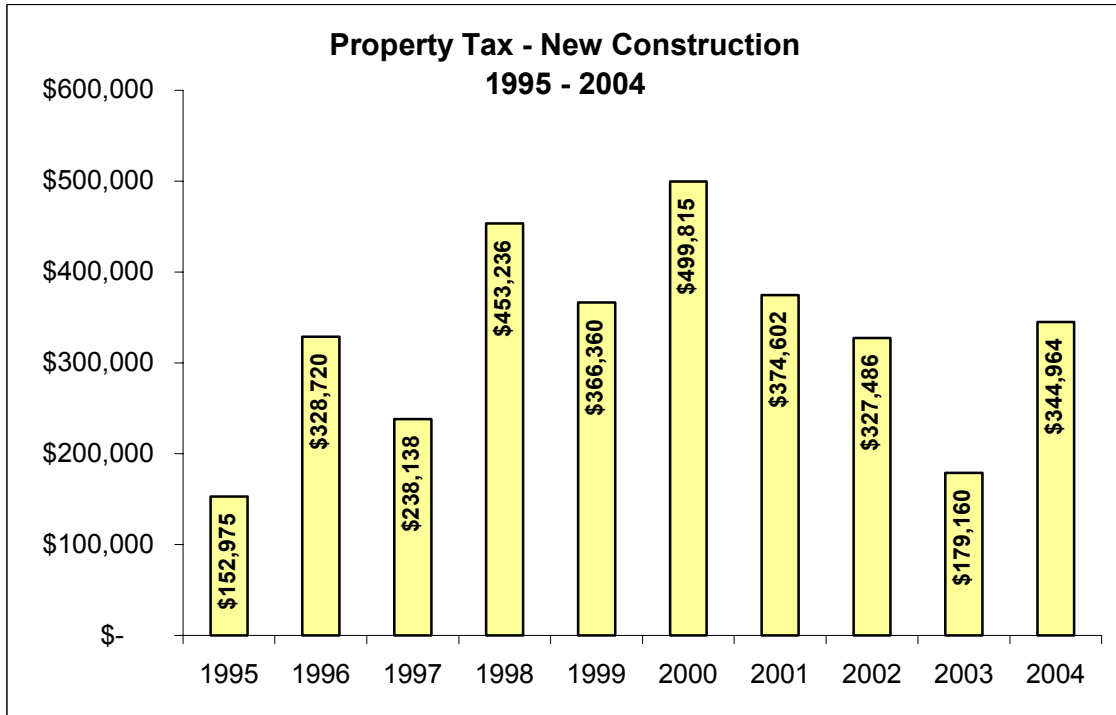
Although Redmond collections are down, the City has performed relatively well compared to surrounding jurisdictions.

Property Tax: Property tax is the City's second-largest revenue source, and similar to sales tax growth, has not kept pace with inflation. Under state law property tax can be increased by 1% per year with Council approval plus new construction. As shown in the table below, ***over the last ten years the City's property taxes have not kept pace with inflation and were increased only three times for a total of 8%. During this same period, inflation rose 32%.*** The impact of foregoing property tax increases in the past 10 years is approximately \$22.4 million.

**Property Tax Increases
Approved 1995-2004**

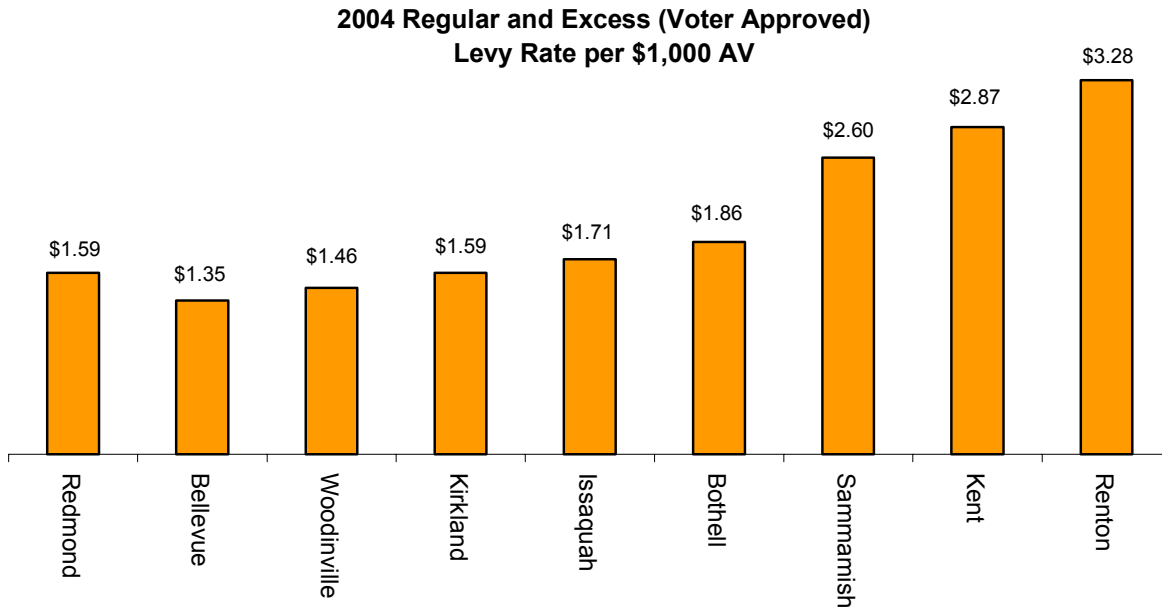
Year	Increase
1995	0%
1996	0%
1997	3%
1998	3%
1999	2%
2000	0%
2001	0%
2002	0%
2003	0%
2004	0%

New construction from 1995-2004 has fluctuated consistent with building cycles in the City. Collections were strong in the late 1990s and early 2000 as construction activity occurred at record levels. However, from the peak in 2000, new construction has fallen by 31%. While new construction increased in 2004, its volatility from one year to the next makes it difficult for the City to rely on this unstable revenue source to pay for the ongoing cost of general government services such as police, fire, parks, etc.



Source: King County Assessor

The City's decisions to keep property taxes low has led to Redmond, at \$1.59 per \$1,000 of assessed value, having one of the lowest tax rates of surrounding jurisdictions. Only the cities of Bellevue and Woodinville have lower rates.



Source: King County Assessor's Office

Even when you translate the property taxes paid by residents into a cost per day, these taxes appear low especially in light of the high quality of services the community receives and has come to expect in the areas of police, fire, parks, etc.

**Snapshot of Average Property Taxes Paid Per Day to the City of Redmond
Per Household**

<u>Residential</u>	<u>Property Values</u>	<u>Cost Per Day</u>
View Ridge East	\$324,000	\$1.41
Rose Hill	251,000	1.09
Education Hill	267,000	1.16
Marymoor Hill	546,000	2.38
Abbey Road	476,000	2.07
Sheffield Green	448,000	1.95
North Redmond	600,000	2.61

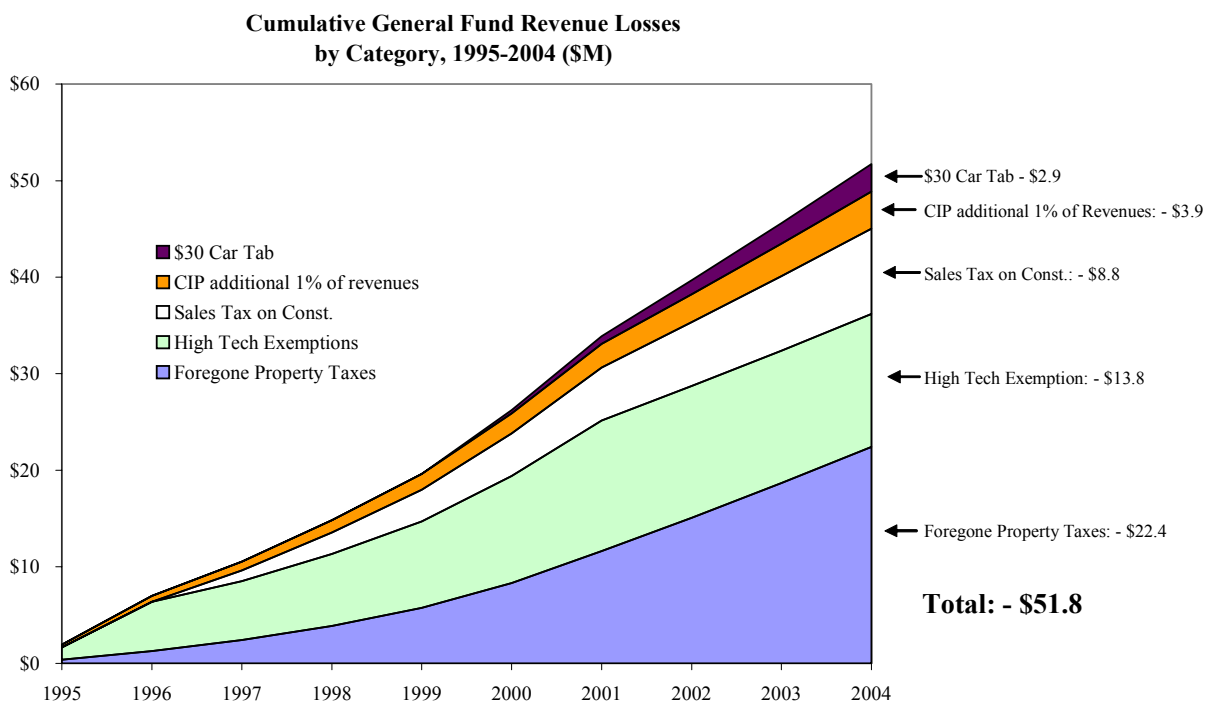
Given the variability of the size and number of employees within a commercial development, it is difficult to calculate comparable averages. It is important to understand that neither the amount of taxes paid by residents nor the amount paid by commercial owners has kept pace with inflation or the rising cost of City services. Based on the selected residential and commercial properties that the City has tracked for the last 10 years, taxes for residential properties have increased on average by 1.5% per year, while commercial properties have declined by 1.3% annually. Inflation during this period averaged 3.2%. This is a key issue which policymakers will

grapple with as they develop strategies to address the long-term structural problems inherent between revenues and expenses.

Impact of State and Local Initiatives

City revenues have also been adversely affected by state and local decisions including: state legislation exempting high-tech research and development activity from sales tax and limiting motor vehicle excise taxes to a flat fee of \$30. These measures have resulted in a cumulative revenue loss of nearly \$17 million in Redmond's General Fund. In addition, the need to invest more in Redmond's capital infrastructure has resulted in more General Fund revenues being allocated to the CIP with consequently less money available for ongoing operations. The City contributed an additional \$13 million to the CIP over the last decade. Please note that while it has been and will continue to be prudent to invest in infrastructure, with limited resources the City will need to strike a careful balance between operational and capital needs as it moves forward.

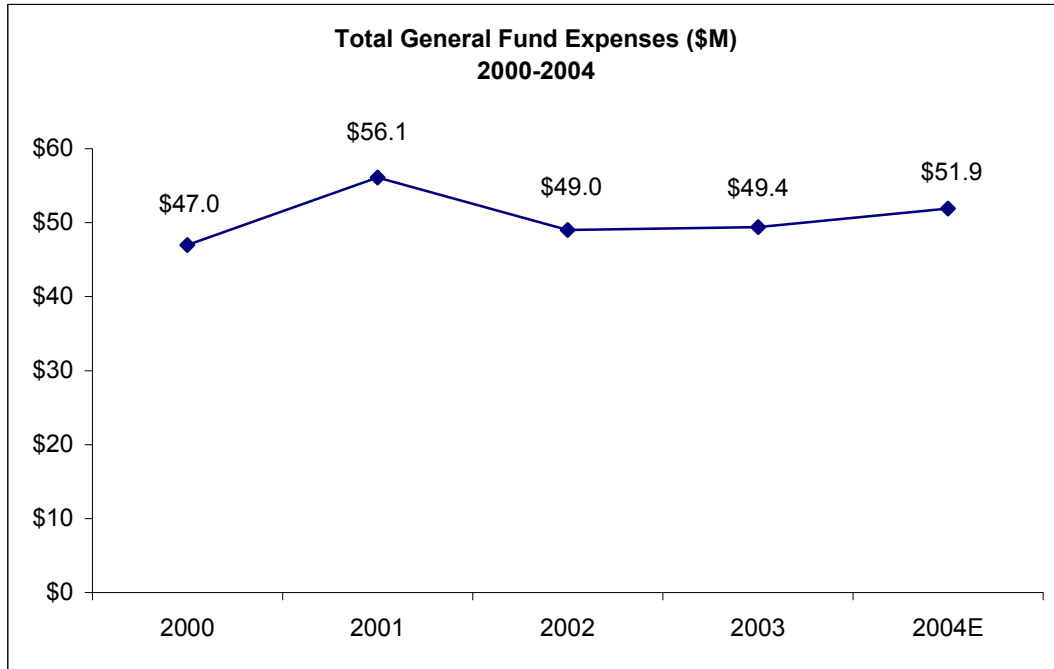
The graph below summarizes the cumulative loss of General Fund revenues over the last 10 years. The total loss to date is \$51.8 million.



The next section examines the actions the City took to successfully manage within its limited resources.

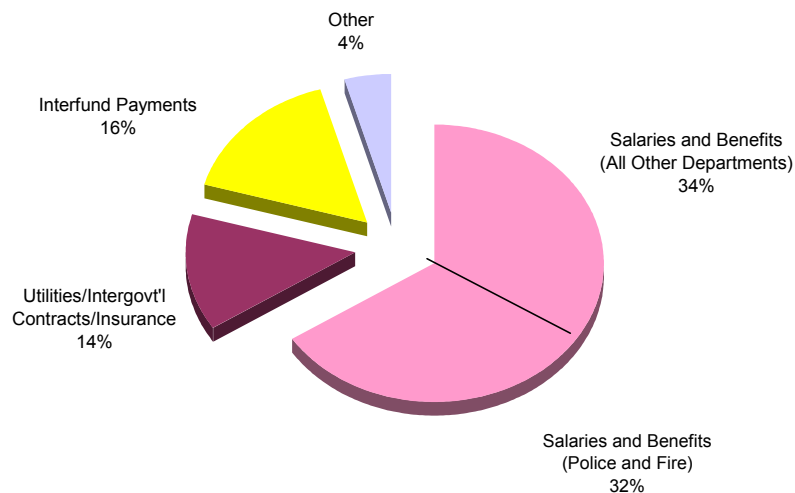
GROWTH IN GENERAL EXPENSES

Over the last four years operating expenditures have grown significantly faster than operating revenues. Expenses grew by \$4.9 million, or an average of 2.5% per year, while revenues were up only \$900,000 or less than .5% per year. As a measure of comparison, inflation has averaged 2.2% during the same period. The following chart shows total General Fund expenses during this period.



Driving the growth in expenses are personnel costs. As City government is an intensive service oriented business, approximately two-thirds of the expenses incurred are related to labor, with public safety accounting for nearly one-half of the City's labor costs.

Expenditures by Object



General labor expenses between 2000 and 2004 increased by an average of 4.4% per year, necessitated by the need to remain competitive within the marketplace and address the higher cost of medical care. Medical costs increased on average 12% to 15% annually and are expected to continue on this path for the foreseeable future. The City has been very aggressive in managing its labor costs. In 2000, it implemented a market-based compensation system and in 2003 negotiated dependent premium cost sharing with most of its labor unions. These actions have served to slow the growth in this category.

As labor costs have risen, other cost centers within the City have declined to keep expenses within revenue constraints:

- Overtime is down from \$1.4 million in 2000 to \$1.1 million in 2004, or 21%.
- Professional services have been reduced from \$2.0 million in 2000 to \$828,000, or nearly 59% since 2000.
- Operating supplies have decreased by 17% between 2000 and 2004, despite cost increases from the City's suppliers.

Limited revenues coupled with the rising cost of doing business resulted in a series of steps to contain costs. These steps included implementing market-based compensation to align salaries and benefits with the market; closely scrutinizing the use of overtime; filling vacancies only when absolutely necessary; negotiating and implementing health benefit cost containment measures; and closely scrutinizing operating costs. As a result of these efforts, the City was able to live within its means over the last four years.

During the 2003-2004 biennium, it is expected that through prudent management departments will under-expend their budgets once again, this time by \$4.6 million or 4.3%. These savings are necessary to ensure expenses remain within the City's lowered revenue base.

	2003-04 Budget	2003-04 Estimate	Difference	Percentage Change
Executive	\$1.0	\$1.0	\$0.0	0.0%
Finance	10.2	9.6	-0.6	-5.9%
Fire	23.1	23.5	0.4	1.7%
Human Resources	1.7	1.6	-0.1	-5.9%
Legal	1.4	1.4	0.0	0.0%
Legislative	0.3	0.3	0.0	0.0%
Non-Departmental	12.2	11.3	-0.9	-7.4%
Parks	9.1	8.3	-0.8	-8.8%
Planning	10.9	9.7	-1.2	-11.0%
Police	20.6	20.1	-0.5	-2.4%
Public Works	16.2	15.3	-0.9	-5.6%
Total	\$106.7	\$102.1	-\$4.6	-4.3%

Source: City Finance Records

In conclusion, while the City has found ways to maintain public services during the economic downturn, the City is at a crossroads. Revenues are no longer sufficient to pay for ongoing City services. Although the 2005-06 budget is balanced through a multi-pronged effort which

includes expenditure reductions, tax and fee increases and use of one-time revenues (see General Fund Overview, Major Revenue Changes for further detail), in the future the City's challenge will be to find ways to close the long-term structural gap between revenues and expenditures while continuing to provide quality services to its community.

OTHER FISCAL ISSUES

Enterprise Funds

In 2004, rate studies were undertaken for each of the City's three Utilities: Water/Wastewater, Stormwater Management, and the Urban Planned Development. The purpose of these studies was to evaluate the financial condition of each Utility and to recommend rate revisions, if any, coinciding with the development of the 2005-06 budget. Recommendations of these studies are as follows:

- **Water/Wastewater Utility:** It was recommended that rates be increased to reflect a pass-through of the higher cost of Metro wastewater treatment charges, higher purchased water costs, and increased cost of operating the City's Water/Sewer Utility. The monthly residential rate was proposed to increase by \$2.72 (\$2.20 for Metro and \$.52 for City water). This rate increase was approved by Council and will go into effect on January 1, 2005.
- **Stormwater Management Utility:** A rate increase was also recommended for Stormwater, as this utility last increased its rates in 1999 to \$11.50, which consisted of a base rate of \$8.50 and a surcharge of \$3.00 to fund an accelerated CIP program. The surcharge was scheduled to sunset at the end of 2004. The City Council allowed the surcharge to sunset as scheduled but increased the monthly base rate from \$8.50 to \$11.50. This rate increase was to adjust the current rates for five years worth of inflation, increase emphasis on the City's Stormwater system, and for operating and capital costs needed to comply with updated and future federal, state and local requirements such as the Department of Ecology Stormwater regulations, Endangered Species Act Salmon Habitat Conservation Plan, Sensitive Areas and Shoreline Regulations, and Wellhead and Critical Recharge Area Protection. It is important to note that the approved rate of \$11.50 is less than the recommended proposal of \$14.85 and will affect the City's ability to address Stormwater issues. The Council has committed to continue to study this utility in 2005.
- **Urban Planned Development Utility:** The Urban Planned Development (UPD) Utility was formed in 2000 for the sole purpose of serving residential and commercial customers in the master planned communities known as Redmond Ridge and Trilogy. This Utility has been supported by strong growth in the number of new residential accounts. Strong demand for single family housing in these developments is expected to continue. As a result, the 2004 rate study concluded that the current rates, along with continued growth in these two communities, would generate sufficient revenue to support the City's costs to operate the UPD Utility in 2005-06. However, similar to the City's Water/Wastewater Utility, rates will increase to pass through an increase in Metro sewage treatment costs, which is expected to add \$2.20/month to residential utility bills beginning January 2005.

Special Revenue Funds

- The 2005-06 budget for the City's Special Revenue Funds is increasing by \$2.0 million or 3.9% reflecting higher than expected real estate excise tax revenues due to strong sales of commercial and residential properties, increased funding from King County Emergency Medical Services to hire three paramedics to transition Medic 35 to full-time, and increasing the per-capita transfer from the General Fund to Arts Activity Fund by \$.25/capita for a total of \$1.50/capita.

Debt Service Funds

- A decrease in the budget for the City's Debt Service Fund is expected commensurate with the retirement of the 1992 refunding general obligation (G.O.) bonds in December, 2005. These bonds refunded the debt outstanding on the 1986 general obligation bonds issued for the Public Safety Building, Senior Center, and three street projects. With the retirement of these bonds, the City only has one general obligation bond issue outstanding: the 1994 Unlimited Tax G.O. which was issued for the construction of the SE Redmond fire station, acquire land in northeast Redmond for a future fire station, and refund the 1990 Parks Bonds. These bonds, which will have an outstanding principal balance of \$1,735,000 as of 12/31/06, will be paid off in 2013.

Capital Improvement Funds

- The City's 2005-2006 budget for the Capital Investment Program (CIP) is decreasing by 25% as compared to the 2003-2004 budget, largely due to one-time adjustments. Specifically, one-time funding from the business tax has been eliminated; however, new funding will be added to the CIP pending Council approval. Although the business tax was scheduled to sunset in 2004, Council has approved the continuation of the \$55 that goes to Transportation and Transit-related projects through 2006. Collections from this revenue source are projected to be approximately \$7 million over the 2005-2006 biennium. Other changes include eliminating one-time loan proceeds for Grassland and Perrigo Parks and deleting the Motor Vehicle Registration revenue which was repealed by Initiative 776. In addition, the CIP has experienced a decline in impact fees and interest earnings. Major projects which were budgeted in 2003-2004 that have been completed include construction of Perrigo and Grasslawn Parks as well as several major transportation projects such as 140th Avenue NE improvements, West Lake Sammamish Parkway rehabilitation, West Lake Sammamish Parkway 51st to Marymoor, 166th Ave improvements and 148th Avenue/40th Street safety improvements.

Internal Service Funds

- The 2005-06 budget for the City's Internal Service Funds is increasing by approximately \$5.8 million due to a 12% increase in health premiums, the transfer of the GIS group into the Information Technology Fund, higher claims costs and reserve requirements for Workers' Compensation, and a rise in fuel prices for the City fleet.

ALERT: Increase in PERS and LEOFF Pension Contribution Rates:

The City was notified in late 2004 that rates for the Public Employees Retirement System (PERS) and Law Enforcement Officers and Fire Fighters (LEOFF) pension systems may be increasing dramatically for the 2005-2006 biennium. The Department of Retirement actuary has recommended the following changes in employer and employee rates effective July 1, 2005. These new rates will go into effect unless modified in the upcoming state legislative session.

EMPLOYER Contribution Rates

	2005-07 Biennium	Current Rates	Percentage increase FY 05-06
PERS 1/2/3	5.08%	1.19%	327%
LEOFF 1	0.00%	0.00%	-
LEOFF 2	4.32%	3.06%	41%

EMPLOYEE Contribution Rates

	2005-07 Biennium	Current Rates	Percentage increase FY 05-06
PERS 1	6.00%	6.00%	-
PERS 2	3.38%	1.18%	186%
LEOFF 1	0.00%	0.00%	-
LEOFF 2	7.20%	5.09%	41%

Source: Association of Washington Cities

If these new rates take effect, the impact on the City's 2005-2006 budget is estimated at \$1.6 million. The chart below summarizes the additional amounts needed by fund.

**Additional Amount Needed Per Fund
to Pay For PERS/LEOFF Rate Increases**

Fund	PERS		LEOFF		2005-2006
	2005	2006	2005	2006	Total
General Fund	\$ 291,802	\$ 588,508	\$ 49,925	\$ 101,094	\$ 1,031,329
Recreation Activity	13,176	26,691			39,866
Arts Activity	657	1,314			1,971
Parks M&O	7,473	14,946			22,419
Special Events	434	867			1,301
Operating Grants	4,199	5,278			9,477
Human Services	166	342			507
ALS	758	1,596	8,973	18,477	29,804
Solid Waste/Recycling	2,838	5,730			8,568
Water/Wastewater Operations	61,903	126,679			188,582
UPD Operations	1,858	3,798			5,657
Stormwater Operations	42,507	86,969			129,476
Fleet	7,399	14,823			22,222
Insurance Claims/Reserve	3,761	7,610			11,371
Information Technology	28,080	57,224			85,304
Total Change	\$ 467,010	\$ 942,374	\$ 58,898	\$ 119,571	\$ 1,587,854